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PUERTO RICO TELEPHONE COMPANY

**SUMMARY OF PRESENTATION
BEFORE THE FEDERAL-STATE JOINT BOARD
ON UNIVERSAL SERVICE**

**Panel on Insular Areas and Alaska
(September 13, 1996)**

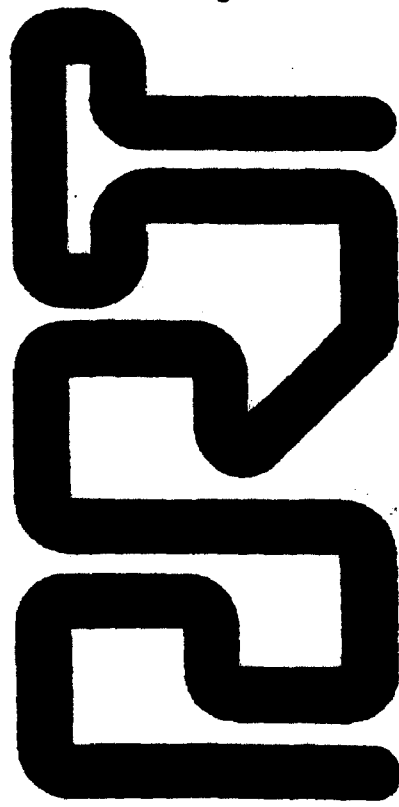
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Puerto Rico
Telephone
Company

TELEFONICA

DE PUERTO RICO

**Statement of
Puerto Rico Telephone Company**

Before the

FEDERAL-STATE JOINT BOARD ON UNIVERSAL SERVICE

Panel on Insular Areas and Alaska

September 13, 1996

I. PROVIDING SERVICE IN PUERTO RICO, AN INSULAR AREA

A. Puerto Rico Telephone Company Mission

In 1974, the Commonwealth of Puerto Rico acquired the Puerto Rico Telephone Company (PRTC) under a statutory mandate "to provide telephone service to every qualified applicant"¹ in Puerto Rico. PRTC believes that this universal service mandate can best be achieved by providing subscribers access to affordable basic telephone service throughout Puerto Rico.

B. Service Penetration in Puerto Rico

When the Commonwealth acquired PRTC in 1974, telephone service penetration in Puerto Rico was barely 25%. Although major strides have been made and modern facilities are now widely available in Puerto Rico, telephone service penetration is low by U.S. standards. Telephone service penetration in Puerto Rico recently reached 74%, but remains as low as 48% in some areas.

1. 27 LPRA § 403(a).

See Exhibit A, Map Depicting Puerto Rico Telephone Service Penetration as of June 1996. By contrast, the overall U.S. penetration rate surpassed 74% 40 years ago,² and now approaches 95%.³

Puerto Rico's penetration increase has been effected without an increase in local rates since 1982. Without universal service assistance, the cost of this network expansion would have forced residential service rates up, which would have slowed the growth in telephone subscribership, and likely driven some low-income subscribers off the network.

C. Providing Service Is Costly Due To Geographic and Economic Factors

The cost of providing service in Puerto Rico is atypically high due to unusual geographic and climatic conditions. Not only does a rugged mountain chain, with peaks exceeding 3500 feet, traverse the entire Island, but the tropical climate and storms are extremely harsh on telephone company plant and equipment. Economic factors such as the high cost of importing of goods to Puerto Rico also increase the cost of service. Moreover, as a result of Puerto Rico's lower incomes, the volume of interstate toll minutes per access line is

2. Department of Commerce, Bureau of the Census, Historical Statistics for the United States from Colonial Times to 1970, Vol. 2 (1975) at 783.

3. See 1996 Monitoring Report, CC Docket No. 80-286 at 17, Table 1.2.

half that of the U.S. mainland, resulting in lower network utilization and higher unit costs. PRTC is concerned that if these high-cost factors are not counterbalanced by sufficient universal service assistance, recent strides made to increase service penetration could be lost.

The proxy models under consideration do not account for certain high cost factors unique to Puerto Rico. For example, the models' emphasis on population density as a primary determinant of loop cost produces an inaccurate proxy result for Puerto Rico. While high population density provides economies of scale in areas of high penetration, the low penetration in Puerto Rico deprives PRTC of these economies which are assumed by the models.

The infirmity of the proxy models is demonstrated by a comparison of actual and predicted costs. For example, the FCC has established an identical local loop proxy ceiling of \$12.47 for Puerto Rico and New Jersey. However, the FCC's 1996 Monitoring Report shows actual local loop cost of \$202.66 for New Jersey but \$356.78 for Puerto Rico, a difference of 76%. The Joint Board therefore should use actual book costs as the basis for distributing assistance.

II. PRTC'S PROPOSAL FOR ADMINISTRATION OF THE UNIVERSAL SERVICE FUND

A. Significance Of Affordable Service

Section 254 of the Telecommunications Act of 1996 mandates that affordability be incorporated into all facets of the high-cost assistance mechanism. To determine affordability, the Joint Board must consider the level of subscribers' disposable income and the cost of service.

In most areas of the United States, where service penetration is nearing 95%, service rates generally appear to be affordable, since only a small fraction of households do not have telephone service. In contrast, the fact that more than one quarter of Puerto Rico's households lack even basic telephone service demonstrates that basic telephone service (while affordable by U.S. standards) may still be beyond the means of many residents of Puerto Rico. This is not surprising since, according to the 1990 census, 55.3% of families in Puerto Rico were living below the poverty line in 1989,⁴ compared to 10% of all U.S. families.⁵ Affordable service thus is not an absolute concept, rather the

4. 1990 Census of Population and Housing. Summary Social, Economic, and Housing Characteristics. PUERTO RICO, 1990 CPH-5-53 (1993) at 191.

5. 1990 Census of Population and Housing. Summary Social, Economic, and Housing Characteristics. UNITED STATES, 1990 CPH-5-1 (1992) at 228.

affordability of service must be considered in relation to subscriber income levels.

The Joint Board can only ensure that rates are reasonably comparable by accounting for the affordability of service in light of subscriber income levels. According to the 1990 census, median U.S. household income in 1989 dollars is 3.37 times greater than in Puerto Rico. (\$30,056 as compared to \$8,895). By ensuring that universal service assistance is available to LECs providing service to economically disadvantaged areas, the Joint Board will direct assistance to those areas where gains in penetration are needed most.

PRTC believes that an affordable universal service rate would be no more than 1% of a household's median income. Universal Service assistance should be provided to compensate for the difference between the actual book cost of providing service and the affordable rate level.

B. Funds Should Be Distributed Based On Low-Income Customers Served

In addition to the universal service support discussed above, PRTC proposes that further assistance be distributed according to the number of low-income subscribers served. A low-income subscriber could be defined as a household with income below the poverty line. The local exchange provider would receive a fixed amount of assistance per low-income subscriber. This

assistance would be applied to reduce a customer's monthly service rate thus helping to fulfill the statutory imperative that service rates be affordable.

PRTC's proposal — universal service assistance directed at providing affordable service and payments to low-income subscribers — has important advantages:

- First, it satisfies the Commission's statutory mandate to ensure affordable local service nationwide.
- Second, the mechanism is competitively neutral.
- Third, it would not require reliance on speculative, unproven proxy cost models that may not target assistance to areas of greatest need.
- Fourth, the proposal meets the requirement that all universal service support be explicit.

For these reasons, the Joint Board should adopt PRTC's proposal.

III. RELATIONSHIP BETWEEN FCC LOCAL COMPETITION ORDER AND UNIVERSAL SERVICE PROCEEDING

The Joint Board must carefully consider the relationship of this proceeding and the Local Competition Order as well as the upcoming access charge reform proceeding. LECs have been able to provide affordable basic local telephone service, in part, because interexchange carriers have paid interconnection rates and access charges that fully cover LEC book costs. The

recently adopted FCC interconnection rules (and the prospective FCC access charge rules) will reduce these interconnection and access payments and will create serious economic shortfalls. Therefore, it is vital that the Joint Board establish a universal service mechanism that fulfills the statutory mandate of affordable service.

EXHIBIT A
MAP DEPICTING PUERTO RICO SERVICE PENETRATION RATES
AS OF JUNE 1996

PERCENTAGE OF HOUSEHOLDS WITH A TELEPHONE AND TOTAL ACCESS LINES IN-SERVICE JUNE 1996

SANTURCE ESTE 70% / 29211
SANTURCE OESTE 77% / 51902
HATO REY-RIO PIEDRAS 81% / 120205
ISLA VERDE 88% / 11801
PUEBLO VIEJO 88% / 78608
GUAYNABO 95% / 37320

